(43)

No. 92-1384

In The

Supreme Court of the United States

October Term, 1993

BARCLAYS BANK PLC,

Petitioner,

v.

FRANCHISE TAX BOARD, An Agency of the State of California,

Respondent.

On Writ Of Certiorari To The Court Of Appeal Of The State Of California In And For The Third Appellate District

BRIEF FOR RESPONDENT

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QUESTIONS PRESENTED

1. Whether the California Supreme Court properly declined to apply a dormant Commerce Clause analysis and properly held that, due to congressional acquiescence, California did not violate the Foreign Commerce Clause by application of worldwide combined reporting to determine the taxable California income of the Barclays taxpayers.

2. If a dormant Commerce Clause analysis were appropriate, would California's use of worldwide combined reporting violate the discrimination element of such a dormant analysis even though California applied the same tax and reporting requirements upon all taxpayers, whether their multinational group was headed by a foreign or a domestic parent corporation?

3. Even though California's practice is held to be valid under the Foreign Commerce Clause, whether California's application of worldwide combined reporting to the Barclays taxpayers is nevertheless preempted by the United States Constitution as an intrusion into an inherently federal area; specifically, whether the Executive Branch's foreign affairs powers can eclipse Congress' exercise of its treaty and Commerce Clause powers to permit such state use of worldwide combined reporting.

4. Whether California's tax reporting procedures, which permit taxpayers to avoid high compliance expenses through the use of reasonable approximations, and which provide for court review of any claimed abuse of administrative discretion, deny taxpayers due process of law.

TABLE OF CONTENTS

TABLE OF CONTENTS – Continued

TABLE OF CONTENTS – Continued

TABLE OF CONTENTS – Continued

TABLE OF AUTHORITIES

Page

TABLE OF AUTHORITIES – Continued

Page

TABLE OF AUTHORITIES – Continued

TABLE OF AUTHORITIES – Continued

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BRIEF FOR RESPONDENT

SUPPLEMENTAL STATEMENT OF THE CASE

This case presents a constitutional law challenge to California's application of worldwide combined reporting ("WWCR"). Under WWCR, formula apportionment is applied to the combined net income of a multinational and multicorporate unitary business in order to determine the net income earned in California by a specific corporation. The three-factor formula used in WWCR, and the arm's length/separate accounting ("AL/SA") alternative which Barclays is asking this Court to impose upon California, are described in detail

by the California Supreme Court in its opinion. PA C-4 to C-5.[1]

A hybrid of WWCR and AL/SA, called the "water's edge" approach, allows both foreign-based and domestic-based unitary businesses to choose to confine application of WWCR to United States incorporated entities and, only in limited circumstances, to some portion or all of foreign incorporated entities. See PA C-35. Since at least 1984, the federal Executive Branch has been encouraging the voluntary adoption of water's edge legislation by the WWCR states. Exs. 29, 371. No state any longer requires full WWCR application to all multinational unitary groups. California adopted its first water's edge legislation in 1986 (JA A-696 through A-745); this legislation was amended in 1993. See Bd.'s Supp. Br. in Opp. The Solicitor General has reported to this Court that those amendments "have brought that State's law into acceptable harmony with federal and international 'arm's length' tax practice." October 1993 Brief for United States as Amicus Curiae, p. 10.

In this case, involving income year 1977 for franchise tax year 1978, WWCR was used to determine the California net income of two taxpayers, Barclays Bank International, Inc. ("BBI"), incorporated in England, and Barclays Bank of California ("Barcal"), incorporated in California (referred to together as the "Barclays taxpayers"). JA A-9 through A-14.[2]

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[1] In this brief respondent Franchise Tax Board (the "Board") has adopted the same record citation abbreviations detailed by petitioner Barclays on page one of the Brief for Petitioner (which will be cited herein as "Br.Pet.").

[2] Due to subsequent corporate mergers and sales, the tax claims of the Barclays taxpayers are now being pursued in this Court by petitioner Barclays Bank PLC ("Barclays"). Br.Pet. ii. The amounts directly at issue in this case for the Barclays taxpayers are relatively small: $1,678 additional tax (12 percent more than reported) assessed to BBI, and $152,420 additional tax (28 percent more than reported) assessed to Barcal. JA A-13 to A-14. As Barclays has pointed out to this Court in its earlier supplemental brief (p. 1), this case as a precedent has approximately $1 billion in California tax revenues at stake. When the *Barclays* and *Colgate-Palmolive Co.* v. *Franchise Tax Bd.* ("*Colgate*"), No. 92-1839, cases are considered together, more than $4 billion ultimately is at risk. Br.Pet. in *Colgate*, p. 38.

Key facts are undisputed. The two Barclays taxpayers, Barcal and BBI, have stipulated: (1) that they did business in California and were members of a worldwide unitary business composed of the members of the Barclays Group, headed by Barclays Bank Limited ("BBL") (JA A-9 to A-11, A-16); (2) that they are not contending in this case that the three-factor apportionment formula used by the Board is unfair, nor are they contending that any distortion resulted from the Board's application of the unitary method in this case (JA A-832 to A-833);[3] and (3) that they have withdrawn from this case any issue as to whether application of WWCR violates the nondiscrimination clauses of United States income tax treaties (R 1815-24).

Much of petitioner Barclays' statement regarding the case consists of arguments dressed as facts.[4] However, these are sins of argumentative excess rather than instances of direct "inaccuracy or omission" under rule 24.2. To counter all such statements in this Supplemental Statement of the

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[3] This stipulation resulted in the trial court's refusing to permit the Board to present any evidence solely to establish the fairness of California's formula and the lack of significant distortion (R 1549-1554). Despite this stipulation, the Brief for Petitioner is larded with arguments dependent upon perceptions that California's formula led to an unfair result, with extraterritorial taxation resulting from distortion. See, *e.g.*, Br.Pet. 5, 7, 16, 24, 25. Although Barclays usually tries to circumvent its fundamental and limiting stipulation by attributing these perceptions to others, there can be no question that overall, and contrary to the stipulation, the Brief for Petitioner rests substantially upon unproven allegations of unfair apportionment and formulary distortion.

[4] Note the argumentative types of sources which Barclays cites for support throughout its statement of the case. For example, Barclays cites several sources to support its contention that California's WWCR method of tax accounting is "incompatible" with AL/SA. Br.Pet. 5. The source which uses the word "incompatible" is an advocacy statement ("United Kingdom Versus Unitary Taxation") made to the United States Treasury Working Group on Worldwide Unitary Taxation on behalf of the United Kingdom. JA A-68, A-70. Clearly this Court is not bound by the argumentative characterization of California's tax by the government which has refused to recognize the validity of this Court's own 1983 evaluation of WWCR and AL/SA. Notice should also be taken of Barclays' repeated and extensive reliance on the first opinion of the California Court of Appeal (see, *e.g.*, Br.Pet. 25, 26, 44). This is the opinion which (under California rule of court 976) was superseded by the California Supreme Court's granting of review and which was reversed by the California Supreme Court on the merits.

Case would leave no room for the Board's argument. Therefore, confident that the Court can distinguish a fact from an argument, the Franchise Tax Board will counter the Barclays "fact" arguments in the argument sections of this brief. For a more neutral presentation of the facts surrounding this case, reference can be made to the California Supreme Court's statement (PA C-2, C-4 through C-13, C-27 through C-31, C-33 through C-37) of the factual, procedural, legislative and case law background, which is included herein by reference.[5]

SUMMARY OF ARGUMENT

When presented to the Senate for ratification in 1976, the United States/United Kingdom income tax treaty ("US/UK Treaty") contained an explicit ban on the states' use of worldwide combined reporting (WWCR). That proposed ban was the subject of intense and prolonged Senate debate. Ultimately, the treaty could achieve Senate approval only when conditioned on the removal of that prohibition, thus indicating continued permission for the states to use WWCR.

In this case the fiscal security of the State of California is threatened because California has imposed just the sort of state tax that the ratified version of the US/UK Treaty permits. Is congressional permission for California to apply WWCR to foreign commerce eclipsed by a later presidential press release, or by a letter from the Secretary of State which asks the Governor of California to seek legislative changes? Can that congressional permission be erased by United Kingdom threats of retaliation which would be a direct violation of that treaty? If so, there has been a major shift in the points of balance which the United States Constitution provides between the Legislative and Executive Branches, and between the national and state governments.

[5] Facts involving the following subjects are found below as indicated: negotiation and ratification of the US/UK Treaty – pp. 20-22; bilateral income tax treaties and Friendship, Commerce and Navigation treaties – pp. 15-18; Executive Branch actions which acknowledge congressional acquiescence in the states' use of WWCR – pp. 25-27; the Barclays taxpayers' costs of compliance with California WWCR – pp. 40-41; California water's edge election legislation – pp. 30-31.

If Congress has acquiesced in the states' use of WWCR, California's use of WWCR cannot violate the Commerce Clause – the Constitution gives Congress the power to regulate foreign commerce. The Constitution also protects the interests of the states by requiring that any treaty must be approved by at least two-thirds of the senators present. Both of these constitutional provisions have important roles in determining the outcome of the Commerce Clause issue presented by this case.

Almost all United States income tax treaties restrict the federal government from engaging in WWCR, and most such treaties restrict the states in some aspects of corporate income taxation; however, no treaty restricts the states' use of WWCR. In 1975 the United Kingdom sought to break from this established pattern by negotiating the insertion into the US/UK Treaty of a ban on state use of WWCR. That ban could not and did not survive Senate review of the negotiated treaty. There was only one way the US/UK income tax treaty could obtain the required two-thirds approval in the Senate: through the Senate's attachment of a reservation "declining to give its consent to a provision in the treaty that would have extended the restriction against [WWCR] apportionment taxation to the States." (*Container Corporation* v. *Franchise Tax Board*, 463 U.S. 159, 196 (1983) (hereinafter "*Container*"). The congressional record of Senate debates on the US/UK Treaty explicitly documents (1) the intense congressional focus upon the WWCR foreign commerce issues and (2) the ultimate decision to permit the states' use of WWCR by removing the explicit ban on such use which otherwise would have been part of the final treaty.

Short of explicit permission in the language of the treaty itself, there could be no clearer indication of Senate acquiescence in the use of WWCR by California and other states. Unless California must show such an explicit statement in the law itself, that acquiescence makes California's use of WWCR immune from all Commerce Clause attack.

No explicit permission need be found in the terms of the treaty. The clear congressional record regarding the Senate's removal of the state WWCR ban from the US/UK Treaty

provides considerably more documentation of congressional permission than precedent requires. The final terms of the US/UK Treaty are consistent with all other United States income tax treaties, and such terms by themselves fully establish congressional acquiescence by implication. Under *Wardair Canada, Inc.* v. *Florida Dept. of Revenue*, 477 U.S. 1 (1986) ("*Wardair*"), and *Itel Containers International Corp.* v. *Huddleston*, 113 S.Ct. 1095 (1993), the treaty provisions alone, by barring the national government from using WWCR while at the same time restricting state income-based taxes in some respects but not as to WWCR, establish congressional awareness of the WWCR issue and congressional intent to permit state use of WWCR.[6] The special and compelling facts of the US/UK Treaty's negotiation and ratification history merely confirm beyond doubt the implication which can be found in the treaty provisions themselves.

Since there has been authoritative congressional action which permits California's use of WWCR in the foreign commerce context, the Commerce Clause is not dormant here. There is no need for any dormant Commerce Clause analysis. Even if the California tax were guilty of all the sins imputed to it by Barclays or Barclays' *amici* – even if it imposed unfair apportionment, gave rise to justifiable foreign retaliation, created automatic asymmetry with inevitable multiple taxation, and discriminated on its face against foreign companies – Congress' actions permitting California's use of WWCR would preclude possibility of any *Commerce Clause* violation.

In any event, even though any dormant Commerce Clause analysis would be totally superfluous in this case, if such an analysis were applied here it would establish that California's use of WWCR led to none of these purported consequences.

[6] While this Court in *Container* considered whether Congress had ever issued a clear federal directive preempting the states' use of WWCR, the *Container* opinion did not consider whether Congress had ever acted to permit the use of WWCR by the states.

California's application of WWCR results in fair apportionment of income. In *Container*, which involved a domestic-based multinational business, this Court held that California's version of WWCR was a fair and proper method of taxation, with income apportionment which did not operate unconstitutionally to tax extraterritorial values. There is no basis for reaching a different conclusion when, as here, a foreign-based multinational business is involved. The Barclays taxpayers conceded this point by stipulating at trial to remove the issue of unfair apportionment and distortion from this case.

Since in *Container* this Court has resolved that California's use of WWCR is a fair and proper means of income apportionment, under a "one voice" dormant Commerce Clause analysis no foreign retaliation can be justified on the misconception (shared by many of Barclays' *amici*) that WWCR is unfair, improper and distortive. Also, the record shows that Congress has long had the state WWCR issue before it, including foreign contentions such as distortion and unfair compliance burdens, and with that awareness Congress has taken no action to preempt state use of WWCR. Clearly, Congress does not consider this "an area where federal uniformity is essential" (*Container* at 193), or Congress would have enacted one of the bills (or would have ratified the US/UK treaty as initially negotiated) which would have required just such uniformity. Therefore California's use of WWCR has not prevented the federal government from speaking with one voice in international trade. Furthermore, the federal Executive Branch, after more than a decade of working for cooperative harmonization of the states' tax prerogatives with the Executive Branch's foreign policy concerns, has solved the problem to its satisfaction and has finally certified to this Court that California's law now is in acceptable harmony with international practices. Under these present circumstances, this Court should not be drawn into the political arena of "one voice" foreign policy speculations.

California's use of WWCR does not result in unconstitutional multiple taxation. The actual *Container* holding as to multiple taxation was based on one determination: while

multiple taxation of income might be presumed to result from California's application of WWCR, equivalent or greater multiple taxation might result from requiring California to engage in some form of arm's length separate accounting. This holding is not dependent upon the nationality of the taxpayer's ultimate parent. Whether the unitary business is domestic-based or foreign-based, California's application of WWCR to tax the California parts of a multinational business does not result in an unconstitutionally enhanced risk of multiple taxation.

There could be no violation of the discrimination element of a dormant Commerce Clause analysis. California's tax does not differentiate between members of domestic-based and foreign-based multinational businesses; the same tax and reporting requirements are imposed upon all businesses by California law. Contrary to Barclays' position, California's law cannot become unconstitutionally discriminatory because *federal* tax law imposes different reporting burdens for federal tax returns.

A determination that California's use of WWCR is valid under the Commerce Clause necessarily means that the tax cannot be invalidated on "foreign affairs" grounds. Either Congress, in full control of foreign commerce, has given permission (which is binding on the Executive Branch), or a dormant Foreign Commerce Clause analysis has already included a balancing and determination of foreign affairs issues in reaching the holding which validates the tax.

California applies WWCR in a manner which fully satisfies the requirements of due process. Compliance with WWCR accounting can be achieved at a very moderate cost through the use of reasonable approximations, as permitted by the California regulation's terms. "Reasonableness" is a fully meaningful standard which is often used in due process jurisprudence. The California courts have determined that California law provides for full court review of the Franchise Tax Board's discretionary determinations of what approximations are reasonable.

ARGUMENT

I. INTRODUCTION: *CONTAINER* AND THIS COURT'S ESTABLISHED RECOGNITION OF THE MERITS OF FORMULARY APPORTIONMENT.

This case is a natural outgrowth of this Court's 1983 decision in *Container*. It is therefore necessary to be clear at the outset about key conclusions which this Court has already reached in *Container*:

1. Due Process Clause and Commerce Clause nexus is established for purposes of applying WWCR whenever some part of the unitary business is conducted in the taxing state. 463 U.S. at 165-66.

2. WWCR's use of formula apportionment of income does not result in taxation of non-California corporations or in taxation of non-California income; it is only a means of determining what portion of the unitary income can be fairly attributed to the part of the unitary business that actually is being conducted in California. 463 U.S. at 164-65, 184, 192.

3. The three-factor formula used by California in applying WWCR has become something of a benchmark against which other apportionment formulas are judged, because property, payroll and sales appear in combination to reflect a very large share of the activities by which value is generated. 463 U.S. at 170, 183.

4. WWCR is a proper and fair method of taxation which reflects a reasonable sense of how income is generated, and which avoids the basic theoretical weaknesses of AL/SA. 463 U.S. at 169-70, 181, 184.

5. Separate accounting is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single worldwide enterprise. 463 U.S. at 164-65.

6. When considering distortion contentions which compare WWCR results with profit or loss determinations made under AL/SA, one must keep in mind it is the basic theoretical weaknesses of AL/SA which justify resort to formula apportionment in the first place. 463 U.S. at 181-82.

7. While actual double taxation was assumed to exist in the *Container* context (463 U.S. at 187 & n. 22), there was no enhanced risk of double taxation violative of dormant Foreign Commerce Clause analysis. Although AL/SA is used by the federal tax authorities and foreign governments, California's use of WWCR does not result in inevitable multiple taxation. California's switch to any particular AL/SA method might only increase a taxpayer's risk of multiple taxation, because of the substantial lack of uniformity in the ways the various nations apply AL/SA.[7] Under these circumstances it would be perverse to require California to give up one allocation method (WWCR) which sometimes results in double taxation in favor of another allocation method (AL/SA) which also sometimes results in multiple taxation. 463 U.S. at 163, 184, 191, 192-93.

8. When *Container* was decided in 1983, no clear federal directive prohibited state use of WWCR. When determining whether such a clear federal directive exists, the Court looks to specific indications of congressional intent. No such preemptive intent shall be drawn from treaty restrictions which are placed solely upon the national governments. 463 U.S. at 196-97.[8]

[7] The lack of uniformity which exists between the United States and the United Kingdom AL/SA rules is dramatically illustrated in this case by BBI's comparison, for United Kingdom double tax relief purposes, between BBI's United States income as computed under U.S. AL/SA and U.K. AL/SA. Using United States AL/SA procedures, BBI showed a very substantial loss for the year ended September 30, 1977. Under United Kingdom AL/SA, the same United States operations were shown as generating a large profit for the same period. Ex. 51J. The immense difference arises because the AL/SA rules of the United States and the United Kingdom are different.

[8] This preemption analysis was the only *non*-dormant Commerce Clause analysis in *Container*. When dealing with the question of the "one voice" of the federal government in foreign commerce, *Container* only considered whether California's application of WWCR *violated* either one of two branches of the one voice standard, indicating that the state tax "will violate the 'one voice' standard if it *either* implicates foreign policy issues which must be left to the Federal Government [the dormant clause branch of the standard] *or* violates a clear federal directive." 463 U.S. at 194 (emphasis by the Court). Thus the only non-dormant

9. Absent some explicit directive from Congress, AL/SA treatment of income by federal tax authorities does not mandate uniform, identical treatment by the states. 463 U.S. at 194.

10. The possible implication of foreign affairs, which are more the province of the Executive Branch and Congress than of the courts, is included within the consideration of the "one voice" test of a dormant Foreign Commerce Clause analysis. 463 U.S. at 194-96.

11. In the application of the "one voice" test in a dormant Foreign Commerce Clause analysis, the most obvious foreign policy implication is whether the state tax might justifiably lead to significant foreign retaliation. The *Container* result indicates that the mere existence of a difference between the income allocation methods of a state and a foreign country does not provide grounds to justify foreign retaliation. 463 U.S. at 194-96.

Container was the culmination of a long history of this Court's recognition of the merits of the unitary method of apportioning income. As this Court stated in *Trinova Corp.* v. *Michigan Dept. of Treasury*, 498 U.S. 358, 378 (1991), "since *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113 (1920), we have recognized the impracticability of assuming that all income can be assigned [by geographic designation] to a single source." And as stated by this Court in 1992, "The principal virtue of the unitary business principle of taxation is that it does a better job of accounting for 'the many subtle and largely unquantifiable transfers of value that take place

Foreign Commerce Clause analysis in *Container* was a consideration whether the one voice had spoken to *preempt* California's use of WWCR. *Id.* In the words of the *Barclays* trial court, *Container* "did not address the question of whether such policy was expressed Congressionally *for* it." PA A-31 (emphasis by the court). *Container*'s consideration of "specific indications of congressional intent" (463 U.S. at 196) was restricted to the preemption analysis, with this Court deciding that "we cannot conclude that the California tax at issue here is preempted by federal law. . . . " *Id.* at 197. Since the *Container* Court did not even consider whether the federal government's one voice had spoken to *permit* California's use of WWCR, no *Container* holding is contradicted when the later *Wardair* analysis is applied in the present case to find such permission.

among the components of a single enterprise' than, for example, geographical or transactional accounting." *Allied-Signal, Inc.* v. *Director, Div. of Taxation*, ___ U.S. ___, 112 S.Ct. 2251, 2261 (1992).

II. THE CALIFORNIA SUPREME COURT CORRECTLY HAS APPLIED *WARDAIR* TO HOLD THAT, BECAUSE COMPELLING IMPLICATIONS OF CONGRESSIONAL ACQUIESCENCE ARE FOUND IN CONGRESSIONAL ACTIONS, CALIFORNIA'S USE OF WORLDWIDE COMBINED REPORTING IS VALID UNDER THE COMMERCE CLAUSE, WITH NO NEED FOR ANY DORMANT COMMERCE CLAUSE ANALYSIS.

A. Congress' Commerce Clause powers and this Court's *Wardair* decision.

The United States Constitution gives the power to regulate foreign and interstate commerce to *Congress*. U.S. Const. art. I, § 8(3); PA App. F. Thus, as to foreign or interstate commerce matters, congressional action prevails over any conflicting actions or desires of the Executive Branch. See *United States* v. *Curtiss-Wright Export Corp.*, 299 U.S. 304 (1936); *United States* v. *Guy W. Capps, Inc.*, 204 F.2d 655 (4th Cir. 1953), aff'd on other grounds, 348 U.S. 296 (1955). If Congress has exercised its commerce powers so as to permit state action there cannot possibly be any violation of the Commerce Clause. Once such permission is ascertained, "any action taken by a State within the scope of the congressional authorization is rendered invulnerable to Commerce Clause challenge." *Western & Southern L.I. Co.* v. *Bd. of Equalization*, 451 U.S. 648, 653 (1981); see also *Wardair*, 477 U.S. at 12-13. Given Congress' total power in regulating foreign and interstate commerce, in granting such permission Congress is unrestricted by any of the policy standards which would apply in a *dormant* Commerce Clause context.

In *Container* this Court upheld the constitutionality of California's worldwide combined reporting method as applied to a multinational unitary business with a domestic ultimate parent. This Court reserved the question of whether it would

reach the same result if (as in this case) the ultimate parent corporation were foreign. 463 U.S. at 193-97.[9]

Three years after *Container*, in *Wardair*, this Court provided the analytic tool which, as properly applied by the California Supreme Court to undisputed facts, mandates the resolution of *Container's* reserved question in favor of California's use of WWCR. Noting that a *dormant* Commerce Clause analysis need not be applied when federal law indicates an authoritative federal decision to *permit* the challenged state tax, this Court held in *Wardair* (consistent with such precedents as *South-Central Timber Dev.* v. *Wunnicke*, 467 U.S. 82, 91-92 (1984)) that, even when the law lacks an explicit statement of permission, such a permissive decision can exist by *implication*. *Wardair* requires that such implications are to be drawn from "the *law* as it presently stands," not from any "*aspiration*" for what the law might become. 477 U.S. at 10 (emphasis by the Court).

In *Wardair*, Florida imposed a tax on all aviation fuel sold within the state, and a Canadian airline challenged the application of Florida's tax to fuel used by foreign airlines exclusively in foreign commerce. On the Commerce Clause issue in *Wardair*,[10] the taxpayer and the Solicitor General as *amicus curiae* argued that the Florida tax unconstitutionally

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[9] Since this question specifically was reserved in *Container*, and since Barclays has never sought the overruling of *Container*, respondent Franchise Tax Board has not argued that any decision against the Board in *Barclays* should be applied prospectively only. The Board has argued and continues to argue strenuously that prospective-only application should be given to any adverse decision in *Colgate*, No. 92-1839, which involves exactly the same situation that was presented and resolved in favor of the Board in *Container*. For the reasons given in the Board's brief in *Colgate*, any decision in either *Barclays* or *Colgate* which is based upon the overruling of *Container* should be applied prospectively only.

[10] The *Wardair* Court also held that the Florida tax was not preempted by the Federal Aviation Act, but the Court explicitly stated that it did not rely on a permissive provision of that act "to answer the Commerce Clause issue" present in *Wardair*. 477 U.S. at 6-7. Barclays errs in implying (Br.Pet. 36) that the Federal Aviation Act served in any way as a basis for the *Wardair* Commerce Clause holding. *Amici* supporting Barclays compound this error by arguing that the Federal Aviation Act was "dispositive" in the *Wardair* Commerce Clause holding. See, *e.g.*, Brief for Keidanren, pp. 5-6.

interfered with the ability of the federal government to speak with one voice because there was a federal policy to exempt such fuel from tax. As evidence of the alleged federal "policy," Wardair and the Solicitor General principally relied on (1) the Chicago Convention on International Civil Aviation, an international treaty to which the United States and 156 other countries, including Canada, are parties; (2) a resolution adopted by the International Civil Aviation Organization ("ICAO") in 1966; and (3) more than 70 bilateral agreements into which the United States has entered with various countries dealing with international aviation.

Discussing each of these in turn, this Court pointed out: (1) that the terms of the Chicago Convention precluded the imposition of local taxes on fuel only when the fuel already is on board an arriving aircraft, thus raising a "negative implication" that there had been "a decision by the parties to that convention to address the problem of [state and local taxation] by curtailing and limiting only some of the localities' power to tax, while implicitly preserving other aspects of that authority" (*id.* at 10); (2) that the resolution adopted by the ICAO, while it endorses an international scheme of tax exemption, is merely the work product of an international organization of which the United States is a member and has no force of law (*id.* at 11); and (3) that while most of the 70 bilateral agreements commit the United States to refrain from imposing national taxes of the type imposed by Florida, in none of these agreements has the United States agreed to deny the states the power to tax the sale of aviation fuel; in particular, the agreement between the United States and Canada makes *no mention* of taxation by political subdivisions, "an omission which must be understood as representing a policy choice by the contracting parties. . . . " *Id.* at 11. This Court went on to say:

> "What all of this makes abundantly clear is that the Federal Government has not remained silent with regard to the question of whether States should have the power to impose taxes on aviation fuel used by foreign carriers in international travel. By *negative implication* arising out of more than 70 agreements entered into since the Chicago Convention, the United States has at least acquiesced in state taxation of fuel used by foreign carriers in international travel. Again, in the U.S.-Canadian Agreement only 'national' charges are barred, and we presume that drafters from two federalist nations understood this as representing a choice not to preclude local taxation. It would turn dormant Commerce Clause analysis entirely upside down to apply it when the Federal Government has acted, and to apply it in such a way as to *reverse* the policy that the Federal Government has elected to follow." *Id.* at 12 (emphasis in original).

Thus in *Wardair* the terms of the international agreements showed that the federal government had concurred in barring a type of tax application, but the terms of the bar, as United States law, restricted only the taxing powers of the nations, not of their respective states or other political subdivisions. Under *Wardair*, the implications to be found in such an action establish that in formulating federal law Congress has elected to permit the states to impose the tax application which is barred to the United States. *Id.* at 10, 12.

B. Even without the compelling facts in the history of the US/UK Treaty, under *Wardair* the terms of United States treaties, and Congress' refusal to legislate WWCR restrictions in the face of recurring demands for action, give rise to fully sufficient implications of congressional acquiescence in the states' use of WWCR.

As will be shown below at pages 20-24, there are clear, documented facts in the history of the US/UK Treaty which confirm beyond doubt that Congress has acquiesced in California's use of WWCR. But those facts are the icing on the cake, for even without them *Wardair* would apply to confirm the validity of the California practice.

The California Supreme Court accurately summarized this case's income tax treaty context as follows:

"[N]umerous bilateral tax treaties between the United States and other nations, although precluding use of formula apportionment by the signatory *national* governments, do not include within that prohibition political subdivisions such as the states. And while such tax treaties *do* include subnational governments within the scope of nondiscrimination provisions, they are *not* included within the prescription that the signatory governments employ an AL/SA methodology in taxing local branches of foreign corporations." PA C-27 (emphasis by the Court).[11]

Correctly applying *Wardair*, the California Supreme Court held that the terms of those treaties established an implied congressional acquiescence in state use of WWCR. PA C-34. Here both types of *Wardair* implications of Congressional acquiescence can be found in the provisions of the income tax treaties: (1) since restrictions on global uses of formula apportionment such as WWCR are placed on national but not state governments, an implication arises that the states were not to be subjected to such restrictions, and (2) since the same documents restrict some aspects of state income-based corporate taxation without barring state use of WWCR, consideration clearly was given to restricting state taxes; therefore the

[11] These income tax treaties specifically require the *national* governments to treat a branch of the foreign business in the taxing nation, for example, as "if it were a distinct and separate person engaged in the same or similar activities under the same or similar conditions and dealing wholly independently" with the rest of the corporation and with any other related corporations covered in another article. Ex. 40D (Canada, 1984, a country noted in *Wardair* as a nation with a federal structure), art. VII(2); see also Ex. 40A (Australia, 1983), art. 7(2); Ex. 40B (Austria, 1957), art. III; Ex. 40C (Belgium, 1972), art. 7(2); Ex. 40H (France, 1968), art. 6(2); Ex. 40I (Germany, 1954), art. III(2); etc. Although the nations are barred from using the unitary business concept for global methods of formula apportionment such as WWCR, within the arm's length context required by the treaties there can be (and is) considerable use of apportionment formulas. R 1899-1906; see JA A-423. As to the nondiscrimination clauses which apply to the states in some aspects of income taxation, the Barclays taxpayers have conceded for this litigation that those clauses do not bar state use of WWCR. R 1815-24.

implication of permission for state use of WWCR is doubly confirmed.

In at least one way the permissive implications of the treaty provisions are stronger in this case than in *Wardair*. Whereas in *Wardair* the two types of provisions giving rise to the two types of implications were not found in the same document, most of the income tax treaties now before this Court are documents containing both types of provisions, thus giving the resulting implications a mutually reinforcing synergy which they would not otherwise generate. The drafters of the income tax treaties now at issue obviously knew about the existence of global formula apportionment tax accounting methods such as WWCR.[12] The drafters of these income tax

[12] The possibility (and validity under the United States Constitution) of state application of formula apportionment to foreign businesses has been a matter of clear international notice since at least 1924, when this Court approved New York's application of a unitary business/formula apportionment approach to a British corporation in *Bass, Ratcliff & Gretton* v. *State Tax Commission*, 266 U.S. 271 (1924). As recognized by Barclays (Br.Pet. 7), " 'The League of Nations rejected formulary apportionment (unitary tax) many years ago.' " Thus the California Supreme Court properly refused to accept the supposition that global unitary business formula apportionment as an alternative to separate accounting did not "penetrate the international financial and diplomatic consciousness until the multinational corporate boom of the 1970's." PA C-32.

California did not suddenly change its basic approach in the 1970's – the multinational corporate boom merely brought many more multinational, multicorporate businesses within the natural application of California's multicorporate formula apportionment. JA A-791 to A-792; see also PA C-33 to C-34. This Court's first affirmation of California's use of the unitary method was in 1942, for tax year 1936. *Butler Bros.* v. *McColgan*, 315 U.S. 501, 503 (1942). Multicorporate inclusion within the unitary formula was recognized in *Edison California Stores* v. *McColgan*, 30 Cal.2d 472 (1947). If a taxpayer's business is unitary, California's statute (dating back to 1929) requires application of full formula apportionment. *Honolulu Oil Corp.* v. *Franchise Tax Board*, 60 Cal.2d 417, 425 (1963).

In any event, the list of 40 bilateral treaties which the Executive Branch supplied to the California Supreme Court in 1991 shows that 28 dated from 1970 or later. PA H-10 to H-11. There can be no doubt that the drafters for all 40 of these treaties, which required separate accounting for the national governments, were fully aware of the global unitary business formula apportionment alternative; otherwise, why have the restriction?

treaties obviously were aware that such treaties could impose the same types of limitations on the states as they were imposing on the federal government. Barclays characterizes these provisions as "remote and general." Br.Pet. 40. If Barclays' standards of remoteness and generality had been applied to the provisions from the separate documents in *Wardair*, those documents never would have qualified for recognition by this Court as containing implied acquiescence by Congress for the *Wardair* state tax.[13]

Outside of the treaty context, the California Supreme Court also properly found implied congressional acquiescence for state use of WWCR in the repeated refusals of Congress to enact statutes which would have restricted such use. Ordinarily, and quite appropriately, courts are slow to attribute significance to the failure of Congress to act on particular legislation. However, when the status quo on a highly controversial issue has been challenged in legislative hearings and in repeated attempts at legislation, none of which has ever successfully emerged from any committee, even though other measures on the subject have successfully gained congressional approval, then Congress' inaction supports a conclusion of implied acquiescence. *Bob Jones University* v. *United States*, 461 U.S. 574, 600 (1983). Under those circumstances,

> "It is hardly conceivable that Congress – and in this setting, any Member of Congress – was not abundantly aware of what was going on. In view of its prolonged and acute awareness of so important an issue, Congress' failure to act on the bills proposed on this subject provides added support for concluding that Congress acquiesced in the [status quo, which in *Bob Jones* consisted of] IRS rulings of 1970 and 1971." *Id.* at 600-01.

[13] The California Supreme Court also recognized that as early as the late 1940's United States negotiators of Friendship, Commerce and Navigation ("FCN") treaties "incorporated standards to preserve the states' freedom to employ methods that produced a tax 'reasonably allocable or apportionable' to the taxing jurisdiction" (PA C-33); the Court noted that this standard was viewed by the United States drafters "as 'intended to cover all the various methods, proportionate or otherwise, by which a reasonable tax base might be determined.' (U.S. State Dept., Standard Draft Treaty of Friendship, Commerce and Navigation, prepared by Charles H. Sullivan (Aug. 1980) pp. 202, 203.)" PA C-27. Therefore, the FCN treaties complement the income tax treaties in preserving the states' ability to use formula apportionment methods such as WWCR.

The same special circumstances are present in this case: "vehement and unrelenting international opposition" (Br.Pet. 36) to state use of WWCR, including statements of foreign officials to Congress (see, *e.g.*, JA A-215 to A-218), has resulted in numerous attempts over the past decades to restrict that use. In the words of the California Supreme Court,

> "The parties agreed in a pretrial stipulation that 'various proposed Legislative bills have been introduced in the United States Congress that would, among other things, affect the state's use of worldwide combined reporting.' The stipulation identifies twenty such House and Senate bills spanning twenty years. These range from House Resolution No. 11798 introduced in the House in 1965 (an ambitious 'Interstate Taxation Act' that would have required the states to adopt a two-factor apportionment formula in taxing unitary groups) to 1985 legislation sponsored by the Treasury Department that would have limited state use of worldwide formula apportionment to members of foreign-based corporate groups actually doing business in the United States, that is, so-called 'water's edge' legislation. . . . None of these measures was enacted into law by Congress." PA C-30 to C-31.

The stipulation also noted and contained at least nine congressional committee reports (six of which did not pertain to treaties) which considered state tax issues including WWCR. JA A-23 to A-24, A-47; also see JA A-201 to A-209. Barclays concedes that, like the attempts at legislation detailed in *Bob Jones University,* none of the attempts to legislate restrictions on *state* use of WWCR ever gained even committee approval (Br.Pet. 40), while treaty restrictions on the *federal* government's use of formula apportionment (including WWCR) routinely received Senate approval. As noted by the California Supreme Court (PA C-29), in 1978 Senator Church observed in the Senate hearings on the US/UK Treaty that "For some ten years Congress has been rejecting the type of limitation

on the power of our State governments to tax [using WWCR] which is incorporated in article 9(4) of the pending treaty." JA A-252. Congress has continued to do so ever since, both before and after the Executive Branch in 1986 publicly called to a halt its federal legislative efforts in an effort to obtain a cooperative resolution with the states. JA A-440 to 441.

These extraordinary circumstances parallel the circumstances in *Bob Jones University* which led this Court to find additional acquiescence in Congress' repeated failure to act on a particular type of legislation. In this case repeated congressional refusal to restrict by statute the states' use of WWCR provides an additional indication of congressional acquiescence in such use. As held in *Wardair*, implied acquiescence by Congress in a particular state tax practice is sufficient to remove that practice from all dormant Commerce Clause scrutiny.

C. Application of *Wardair* to the provisions and history of the US/UK Treaty compellingly establishes congressional acquiescence in state use of WWCR.

In holding that the *Wardair* rule was applicable in the present case, the California Supreme Court placed its primary reliance on the US/UK Treaty, which by its terms has effect in the United States generally for tax years beginning on or after January 1, 1975. JA A-474 to A-475. (Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasions with Respect to Taxes on Income and Capital Gains (JA A-444 through A-476).) For the first and only time, in 1975 treaty negotiations the Executive Branch agreed on a treaty provision, here article 9(4), which would have explicitly prohibited any state use of WWCR. JA A-243; see Appendix A hereto for art. 9(4).

After much debate, the entire treaty, with the state WWCR ban, was rejected by the Senate in 1978 (see JA A-392 to A-394). On reconsideration, the treaty achieved the required two-thirds vote for approval only when the WWCR prohibition was rendered totally inapplicable to the states by a

reservation. JA A-238 through A-417 (Senator Church's reservation at A-251, final 6/27/78 vote at A-408 to A-410). In renewed bargaining, the United Kingdom exacted other federal tax concessions from the United States in exchange for dropping the ban on state use of WWCR. JA A-437. Only then did the United Kingdom accept the treaty with the revised prohibition of WWCR applicable solely to the national governments, not to the states. JA A-429 through A-432; JA A-200, A-227 to A-229. Thus the states' use of WWCR was directly considered as a tax issue during the formulation of the treaty, but the *states'* use of WWCR ultimately was not restricted in the final adoption of the treaty as a part of United States law.

The US/UK Treaty provides a perfect context for the application of the *Wardair* rule: a clear congressional consideration of whether a state tax practice (WWCR) should be restricted, and a final ratification of a treaty which by clear implication permitted the states' continued application of that tax practice (WWCR). At the time of the final Senate vote, the clear and publicly acknowledged choice before the Senate was either to ratify the US/UK treaty while permitting the states to use WWCR or (since ratification with original article 9(4) had proved impossible) not to ratify the treaty. See 124 Cong. Rec. 18709-12 (June 23, 1978) (JA A-394 through A-407 – statements of Senators Byrd, Church, Javits, Stevens, Sparkman, Cranston and Packwood).[14]

By more than the required two-thirds vote (82 yeas, 5 nays), the Senate chose to ratify the treaty while permitting (by implication) state use of WWCR. 124 Cong. Rec. 19076 (June 27, 1978) (JA A-408 to A-410). In the words of the *Wardair* decision, the Senate has "at least acquiesced" in the continued use of WWCR by the states, and under the *Wardair*

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[14] For example, Senator Javits, who had been the main proponent of the treaty as negotiated and the main opponent of the Church reservation, stated, "I will vote for the treaty with the Church reservation incorporated in it. I cannot vote for the Church reservation [separately]. I am not a fool; I opposed it. I think it is wrong. But on balance if I have got a treaty and that is the price of it I am going to pay it. So I really hope that is the route we will go." JA A-404.

holding such acquiescence is fully sufficient to establish that the federal government has "affirmatively decided to permit" state use of WWCR. 477 U.S. at 12-13.

The California Supreme Court correctly compared the present case to *Wardair*:

> "The parallels between this evidence of 'governmental silence' or refusal to act and that regarded as decisive in *Wardair, supra*, 477 U.S. 1, seem to us both evident and compelling. As in *Wardair*, an international agreement (here the bilateral income tax treaty between the United States and the United Kingdom) demonstrates that while federal executive branch officials *aspired* to eliminate a state tax practice (here the use of formula apportionment to calculate the tax liability of foreign-based multinationals), 'the *law* as it presently stands acquiesces' in the states' continued use of that practice. As in *Wardair*, the 'negative implications' of international agreements (here the tax treaty as ratified by the Senate) support recognition of a federal policy that *acquiesces* in the states' tax practice. And certainly, in the circumstances of Senate consideration detailed above, the explicit removal of 'political subdivisions' from the scope of article 9(4) effected by the Church reservation, like the omission of restrictions on taxation by political subdivisions in the international agreements considered in *Wardair*, 'must be understood as representing a policy choice by the contracting parties.' (*Wardair, supra*, 477 U.S. at p. 11.)" C-29 to C-30 (emphasis in original; footnote omitted).

Recognizing that formula apportionment such as WWCR has been a matter of international interest from at least the mid-1950's (C-33 to C-34), and noting that indications of such federal acquiescence also were to be found in the history of other bilateral income tax treaties (C-31 to C-34) (see above at pp. 15-18) and in legislative histories of congressional bills (C-31) (see above at pp. 18-20), the California Supreme Court applied *Wardair* to hold that (1) California's application of WWCR in this case has been permitted by Congress under its Commerce Clause powers, and (2) since

Congress has acted to permit such application, no dormant Commerce Clause analysis was necessary.

The establishment of congressional acquiescence is markedly clearer here than it was in *Wardair*. In *Wardair* this Court found that the *terms* of the treaties implied that restrictions upon the type of state tax at issue had been considered and rejected. Implications of at least equal strength can be found in the final terms of the US/UK Treaty. However, in this case the Court can confirm those implications by reference to the congressional record, which explicitly establishes intense congressional consideration and ultimate rejection of a ban upon the states' use of WWCR.[15] It is unmistakably clear that the ban on state use of WWCR which was negotiated between the Executive Branch and the United Kingdom could not obtain the two-thirds Senate approval required by article II, section 2, clause 2 of the United States Constitution. Under these circumstances it is unmistakably clear that the states' use of WWCR has gained the congressional acquiescence which is required under *Wardair* to take a case out of dormant Commerce Clause coverage.[16]

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[15] Barclays refers to a number of cases wherein this Court has not found congressional acquiescence for a particular state practice. Br.Pet. 37. But in none of these cases did the context show that a congressional action had been taken at a time when Congress had directly before it the type of state action in issue. For example, in *Wyoming* v. *Oklahoma*, 112 S.Ct. 789 (1992), this Court quite reasonably did not treat the Federal Power Act's general "saving clause," allowing otherwise valid state statutes to regulate sales of electrical energy, somehow to authorize Oklahoma to require the burning of Oklahoma coal in all coal-burning electrical power plants in Oklahoma. *Id.* at 802. In the present case there can be no question that Congress was aware of the foreign commerce issues of state use of WWCR when acting (as in the rejection of the US/UK Treaty's originally-negotiated state WWCR ban) in response to what Barclays itself refers to as "vehement and unrelenting international opposition" to WWCR. Br.Pet. 36.

[16] Barclays tries to weasel out of this result by claiming that the Constitution's requirement that treaties be approved by a two-thirds senate vote should be disregarded, and that the fact that a simple majority of senators voted for the treaty as negotiated should be determinative. This position is faulty in its logic and incredible in its disregard for the United States Constitution. As noted in senate debate, the WWCR ban showed up in the negotiated US/UK Treaty after ten years of failure in efforts to gain such a ban by statute; the treaty strategy was seen as a

D. Recent confirmation of *Wardair* in *Itel Containers*.

Barclays argues that the California Supreme Court somehow has gone beyond *Wardair* and other more recent decisions of this Court. That argument is fully destroyed by *Itel Containers International Corp.* v. *Huddleston*, 113 S.Ct. 1095 (1993), where this Court concluded its Foreign Commerce Clause discussion with a holding that "the most rational inference to be drawn" from congressional actions was congressional permission for the type of sales tax imposed by Tennessee in that case. *Id.* at 1105. In *Itel*, consistent with *Wardair*, this Court inferred the congressional permission from the simple fact that the state tax did not fall within the types of taxes which had been eliminated in "various conventions, statutes and regulations that restrict a States's ability to tax international cargo containers in defined circumstances. . . . " 113 S.Ct. at 1105. (But *cf. Japan Line, Ltd.* v. *County of Los Angeles*, 441 U.S. 434, 436 n. 1, 446 n. 10, 452-53 (1979), for a pre-*South-Central Timber*, pre-*Wardair* contrary application of the same container convention authority.)

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ploy to get around the inability to legislate such a ban head on. JA A-251 through A-253. The fact that a simple majority of the senators voted for the treaty as negotiated may just show the strength of the ploy – in order to get the rest of the treaty as negotiated, some senators may have been willing to swallow the WWCR ban. Aside from its illogical conclusion, Barclays' two-thirds vote argument is inconceivably flippant in its disregard of the constitutional structure of this federalist nation. It is not merely coincidental that the United States Senate is the body which was given the constitutional power to ratify or reject treaties as negotiated by the Executive Branch. The very makeup of the Senate, with equal representation for each state, is a built-in protection that the states' interests will be considered in the exercise of commerce or foreign affairs powers. *Garcia* v. *San Antonio Metro. Transit Authority* 469 U.S. 528, 551 (1985); see *The Federalist*, No. 62, p. 402 (Mod. Lib. ed. (1937)) (A. Hamilton or J. Madison). The requirement of a two-thirds affirmative Senate vote to ratify any treaty (U.S. Const. art. II, § 2) gives further protection to the interests of the states in the treaty process. See *id.*, No. 64, p. 422 (J. Jay), No. 75, pp. 489-90 (A. Hamilton). Under *Wardair*, which looks to "the *law* as it presently stands" (at 10 (emphasis by the Court)), the question is not what a simple majority of the senators would have *liked*; the question is what the Senate as a body *decided* under the rules set by the Constitution.

The single-justice dissenting opinion in *Itel* criticized the majority for "finding congressional authorization for the tax in congressional silence," by "infer[ring] permission for the tax from Congress' supposed failure to prohibit it." 113 S.Ct. at 1110 (Blackmun, J., dissenting). This echoes both the criticism of the *Wardair* majority opinion in the single-justice *Wardair* dissent and the criticism which Barclays has aimed at the California Supreme Court. While Barclays may not like the *Wardair* approach, there can be no valid question that the California Supreme Court's application of the *Wardair* rule is fully consistent with the current rulings of this Court.[17]

E. Executive Branch actions recognize the existence of the binding congressional foreign commerce decision to permit California's use of WWCR.

Two Executive Branch documents are cited in support of Barclays' claim that, "There is an express and well articulated

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[17] The decision in *Itel* concluded its Commerce Clause holding by quoting from *Wardair*: " 'It would turn dormant Commerce Clause analysis entirely upside down to apply it where the Federal Government has acted, and to apply it in such a way as to *reverse* the policy that the Federal Government has elected to follow.' " 113 S.Ct. at 1105 (emphasis in original). Barclays disregards the ultimate holding in *Itel* and treats *Itel* as a dormant Commerce Clause case. Br.Pet. 37-38. This Court's Commerce Clause discussion in *Itel* does include analysis of dormant Commerce Clause elements, with references to *Japan Line, Ltd.* v. *County of Los Angeles*, *supra*, and *Container, supra*. However, once the last, "one voice," element was reached, this Court focussed on the possibility that Congress had acquiesced in the type of state tax which was at issue. Realizing, under *Wardair*, that such acquiescence would be determinative of the Commerce Clause issue, this Court noted that within the *Itel* context the federal government had acted on the subject matter (state taxation of cargo containers and their use) without proscribing the type of state tax which was directly at issue in *Itel*. Under those circumstances (and utilizing the *Wardair* approach), this Court held in *Itel* that "the most rational inference to be drawn" is that the Tennessee Tax "is permitted." 113 S.Ct. at 1105. This is not a dormant Commerce Clause holding. If the Tennessee tax in *Itel* had *not* passed all the dormant Commerce Clause tests which were considered, the *Itel* Commerce Clause result still would have been the same. This Court's reaffirmation of the *Wardair* holding and approach makes clear that the Tennessee tax still would have been upheld, because Congress, in *non*-dormant actions, impliedly permitted such a state tax. Any other result " 'would turn dormant Commerce Clause analysis entirely upside down.' " 113 S.Ct. at 1105.

policy of the United States on the system to be used for division of income of foreign multinational enterprises among nations for tax purposes. It is the arm's length method." Br. Pet. 23. The first document offered in support of this claim is a 1984 statement by Under Secretary of State Wallis regarding the Worldwide Unitary Taxation Working Group, a statement which begins, "I support the Working Group's recommendation for a 'water's edge' limitation on unitary taxation. . . . " JA A-576. The Working Group's recommendation was for *state* legislation to achieve the *water's edge* result. Ex. 29. The second document is the 1986 letter from Secretary of State Schultz to California Governor Deukmejian, noting the introduction of federal (water's edge) legislation, indicating that Secretary Schultz "believe[d] state worldwide unitary taxation to be inappropriate," and urging "swift legislative or administrative action" by California. This letter was intended to encourage water's edge legislation under the Working Group's recommendation. JA A-601 through A-603; Ex. 37I, Statement of J. Roger Mentz, pp. 12-14.

Although these documents note the federal use of and Executive Branch preference for separate accounting, the clear Executive Branch "policy" embodied in these documents is to encourage WWCR states to legislate water's edge alternatives. But no matter what these documents contained, they could only voice the "*aspiration*" of the Executive Branch; they could not constitute the Commerce Clause "*law* as it presently stands," as is required to bind the states and this Court under the Commerce Clause. *Wardair*, 477 U.S. at 10 (emphasis by the Court).

Whatever the Executive Branch's *aspirations*, the Executive Branch's *actions* recognize the existence of the congressional Commerce Clause decision to permit the states' use of WWCR. Some examples: (1) except for its 1975 negotiation of the ultimately rejected state WWCR ban in section 9(4) of the US/UK Treaty, the Executive Branch has *never* negotiated an income tax treaty or FCN treaty that would either restrict

or prohibit California's use of WWCR (see JA A-243);[18] (2) in 1963 and 1977 the Executive Branch formally reserved its approval of the OECD Model Treaty clause which would make AL/SA requirements in the treaty applicable to subnational taxes (Ex. 44, JA A-501); (3) in December 1993, in conjunction with the General Agreement on Tariffs and Trade, the Executive Branch concluded negotiations on the General Agreement on Trade in Services, which contains language which would provide that state taxes, such as California's unitary tax method (even before its current revision) would not be considered discriminatory;[19] (4) the following Executive Branch testimony was given in 1979 to explain the administration's exclusion of state taxes from the overall coverage of its own Model Income Tax Treaty (Exh. 45, at JA 560):

> "These local U.S. taxes are not covered because it is unlikely that the United States would consent to the ratification of any treaty provision that restricted the rights of the various states to impose their own taxes." JA A-438 (statement of Donald C. Lubick).

Thus the actions of the Executive Branch establish not only the absence of a clear federal directive *prohibiting* WWCR; those actions also establish the Executive Branch's continuing recognition of the congressional Foreign Commerce Clause determination to *permit* California to use WWCR.

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[18] In later negotiations for the income tax treaty with Canada, Canada indicated its unhappiness with state use of WWCR, but both the United States Executive Branch and the Canadian representative expressed the understanding " 'that the Senate of the United States has not consented to any limitation on the taxing jurisdiction of the states by a treaty and that a provision which would have restricted the use of unitary apportionment in the case of United Kingdom corporations was recently rejected by the Senate.' " Therefore, no such limitation was attempted in the treaty with Canada. Ex. 42, JA A-477 through A-478. An identical statement was contained in correspondence exchanges relating to the treaty with France, with the same result. Ex. 43, JA A-480 through 483.

[19] Statement attributed to Assistant Treasury Secretary Daniels in BNA Daily Tax Report (12/14/93), p. G-5.

III. A DORMANT COMMERCE CLAUSE ANALYSIS WOULD LEAD TO THE SAME RESULT: THE VALIDITY OF CALIFORNIA'S USE OF WWCR.

A. There would be no basis for this Court to require uniformity with federal practices under a "one voice" dormant Commerce Clause analysis.

1. In this case Congress has at least indicated that federal uniformity is not essential; therefore this is not an appropriate case for this Court to take any "one voice" action.

Proper application of *Wardair* renders unnecessary any dormant Commerce Clause analysis. Pages 28 through 45 of this brief, which are devoted to such an analysis, should not be necessary. Moreover, the following expedition through the "quagmire" of dormant Commerce Clause analysis (see *Northwestern Cement Co.* v. *Minn.*, 358 U.S. 450, 458 (1959)), leads the reader back to the same conclusion – California's use of WWCR is valid under the Commerce Clause.

The "one voice" element of dormant Commerce Clause analysis involves an area in which this Court has stated it has "little competence" – the area of foreign policy – "whose nuances, we must emphasize again, are much more the province of the Executive Branch and Congress than of this Court. . . . " *Container*, 463 U.S. at 194, 196. Thus this Court is careful to erect a high entry requirement to this analysis: if the state tax does not impair federal uniformity in an area where *federal uniformity is essential*, or if it does not " '*prevent*[] the Federal Government from "speaking with one voice" in international trade,' " *id.* at 193 (emphasis added), this Court will not act in the place of Congress. Thus this judicial function is characterized more by judicial restraint than by judicial action: the Court acts only to prevent irremediable national injury when circumstances inhibit Congress' ability to speak with its authoritative "one voice" under the Foreign Commerce Clause.

It has already been shown above (at pp. 18-20) that Congress has been presented with this issue at least twenty times and has not acted to restrict the states' use of WWCR. Even if this inaction in the face of "vehement and unrelenting international opposition" to WWCR (Br.Pet. 36) did not clearly imply congressional permission for the states to use WWCR (but it does – see above at pp. 18-20), it must at least establish that Congress does not find the issue to be one in which federal uniformity is *essential*. If uniformity were deemed by Congress to be essential, uniformity would have been legislated long before now. Why should this Court act like Congress to legislate uniformity when Congress itself, having had much time and many opportunities to legislate on its own, has plainly decided that it will do nothing to restrict state WWCR use?

In *Quill Corporation* v. *North Dakota*, ___ U.S. ___, 112 S.Ct.1904 (1992), this Court declined to change established law, indicating that, since it involved the Commerce Clause, "the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve." *Id.* at 1916 (footnote omitted). Therefore, even though the Court recognized certain problems with the status quo, this Court left any action to Congress, with the observation that " 'Congress has the power to protect interstate commerce from intolerable or even undesirable burdens.' " *Id.* The same approach is just as appropriate in this foreign commerce case.

2. Federal uniformity is not essential when, as here, the Executive Branch has achieved harmony through cooperative efforts in the political sphere.

In contrast to Congress' resolute inaction as to federal legislative restrictions, the Executive Branch has been resolutely active in attempting to bring about a cooperative resolution of the problem through state enactment of water's edge legislation. As noted above at pages 25-27, the Executive Branch "policy" underlying the documents relied upon by Barclays was the policy formed and recommended by the

Worldwide Unitary Taxation Working Group – to encourage the WWCR states to enact water's edge unitary combination statutes.[20] In his 1984 transmittal letter to President Reagan, the Secretary of the Treasury, as chairman of the Working Group, stated, "If states enact legislation based on the three principles agreed upon by the Working Group, the United States will be able to speak with one voice in dealing with its foreign trading partners, and this irritant to international commercial relations will have been eliminated." Ex. 29 at iii.

Accomplishment of this goal has not been easy, but it has been accomplished. More than a year after the Working Group's report was released, the White House press office issued a "Statement by the President" which indicated that since the unitary states had not universally enacted water's edge statutes, the Executive Branch would be crafting federal legislation to require the water's edge approach, entering into negotiations to amend double taxation agreements, and having the Attorney General protect the United States' interests in appropriate cases (including, eventually, appearances in *Barclays* but not *Colgate*). PA H-46. The federal water's edge legislation was introduced in late 1985.

In 1986 California enacted water's edge legislation, but with certain conditions which engendered their own controversies. JA A-696 through 745. The Executive Branch stated to Congress later in 1986 that "state legislative developments [by California and other states] go a long way toward resolving the difficult unitary tax issue" and "illustrate the successful operation of the Federal system." JA A-440. Although problems remained, the Executive Branch took the position "that restrictive Federal legislation is not warranted at this time" and that no "treaty resolution of the unitary issue is

[20] The Working Group agreed on "Three principles of Agreement": "Water's edge unitary combination for both U.S. and foreign based companies," "Increased federal administrative assistance and cooperation with the states to promote full taxpayer disclosure and accountability" and "Competitive balance for U.S. multinationals, foreign multinationals, and purely domestic businesses." The first principle, water's edge treatment, "would be implemented by state action rather than federal restrictions." Ex. 29, Chairman's Report, pp. 9-10.

necessary or appropriate at this time." Credit was given to President Reagan's "decision in 1983 to seek a cooperative solution" by forming the Working Group. JA A-441 to A-442. The amicus brief which had been filed in this case as part of the strategy to encourage California to enact water's edge legislation (Ex. 37I, Statement of J. Roger Mentz, pp. 13-14) was not withdrawn, apparently to induce California to "respond[] to the federal initiative" (see *id.*) by achieving full harmonization with the Working Group's recommendations.

Finally, in 1993 California amended its water's edge election statute to eliminate all election fees and remove other controversial conditions. See App. A to Supplemental Brief of Respondent Franchise Tax Board in Opposition to Petition for Writ of Certiorari.[21] According to the Solicitor General's October 1993 brief in this case (page 10), the 1993 California legislation had the following result:

> "By removing any mandatory requirement or economic compulsion for taxpayers to report their income under the worldwide combined reporting method, California's recent modifications of its tax system have brought that State's law into acceptable harmony with federal and international 'arm's length' tax practice."

Thus the federal system has been utilized to achieve an accommodation of the international tensions arising from California's use of WWCR. Ten years after the formation of the Working Group, California legislation has been achieved which meets the principles enunciated by the Working Group. As noted by the Secretary of the Treasury in 1984 (see above at p. 30), such enactments enable the United States "to speak with one voice in dealing with its foreign trading partners. . . . " Just as it would turn dormant Commerce Clause analysis entirely upside down to apply it when Congress has acted to permit the state action in issue (see *Wardair*, 477 U.S. at 12), it would turn dormant Commerce Clause analysis completely

[21] The United Kingdom immediately responded by officially indicating that "the UK will therefore defer retaliatory action. . . . " Pet. Supp. App. P, in Supplemental Brief of Petitioner.

inside out to apply the "one voice" element to bar state action under these circumstances. Such "one voice" application at this time would inject the courts into an area in which their competency is admittedly quite limited and would, by disregarding the harmony which has been achieved through cooperative federal/state action, infringe upon what this Court in *Container* termed "the sovereign right of the United States as a whole to let the States tax as they please." 463 U.S. at 194.

As this Court recognized recently in *Allied-Signal, Inc.* v. *Director, Div. of Taxation*, 112 S.Ct. 2251 (1992), "[I]f anything would be unworkable in practice, it would be for us now to abandon our settled jurisprudence defining the limits of state power to tax under the unitary business principle." To do so "would disrupt settled expectations in an area of the law in which the demands of the national economy require stability." *Id.* at 2262. This thought from *Quill Corporation* v. *North Dakota*, 112 S.Ct. 1904, 1916, is fully apposite here:

> "In this situation it may be that 'the better part of both wisdom and valor is to respect the judgment of the other branches of the Government.' "

3. No foreign retaliation is justifiable under the circumstances of this case.

For the reasons already given, this is not an appropriate case for this Court to act in the role of the "one voice" emergency police to safeguard national interests regarding foreign commerce, even if it were assumed that retaliation by foreign governments somehow could be justified. In any event, there is absolutely no basis for justifiable retaliation here.

In the portion of the *Container* "one voice" discussion which was truly a *dormant* Commerce Clause analysis, this Court tested whether California's application of WWCR in the *Container* context might "justifiably lead to significant foreign retaliation." *Id.* at 194. Under the *Container* facts this Court found that three factors (discussed below at p. 37) weighed against there being any such *justifiable* retaliation,

but the Court did not indicate that those factors were the only factors which would apply in every case.

a. Foreign disagreement with United States Supreme Court constitutional doctrine cannot make retaliation constitutionally justifiable.

In its brief, Barclays claims that California's use of WWCR "understandably" (not justifiably) has offended foreign nations. Barclays asserts that WWCR is "*perceived* by foreign nations as an arbitrary, unfair, and predatory method of taxation, the use of which threatens the international standard, imposes unreasonable tax and compliance burdens on foreign-owned taxpayers, and discourages foreign investment in the United States." Br.Pet. 16 (emphasis added).

Disagreement with California as to the fairness and propriety of WWCR cannot form a basis for any "justifiable" retaliation, no matter how "understandable" it might be. To pick a fight with California on this point is to challenge the authority of this Supreme Court. As noted above, this Court in *Container* held California's version of WWCR to be a "proper and fair method of taxation" (463 U.S. at 184) which "reflect[s] a reasonable sense of how income is generated" (*id.* at 169) and which avoids the "basic theoretical weaknesses" of arm's length/separate accounting methods (*id.* at 181). Among the separate accounting weaknesses pointed out in *Container* are that separate accounting "is subject to manipulation and imprecision, and often ignores or captures inadequately the many subtle and largely unquantifiable transfers of value that take place among the components of a single enterprise" (*id.* at 164-65).

Clearly, the foreign governments in Barclays' "perception" reference do not agree with the United States Supreme Court's favorable conclusions regarding the inherent merit of California's WWCR methods. While such foreign nations' reaction might be *understood* if they honestly held these misconceptions as to WWCR, that reaction cannot be *justified* on a basis directly contrary to an applicable and explicit

Commerce Clause holding of the United States Supreme Court.[22] (See also below at pp. 40-43 for misconceptions as to costs of complying with WWCR.)

b. Great Britain cannot justifiably retaliate for a state tax practice it has agreed to in a binding treaty.

It is particularly clear that retaliation by the United Kingdom cannot be justified. In the creation of the US/UK treaty that is still in force, the United Kingdom tried and failed to outlaw American states' use of WWCR. After the Senate refused to ratify the treaty unless the states were removed from the coverage of article 9(4)'s WWCR ban, the parties to the treaty entered into the Third Protocol, which made the prohibition contained in article 9(4) applicable only to the national governments, thus allowing continued WWCR use by the states. JA A-429 to A-432. The United Kingdom only agreed to this result after extracting other concessions from the United States in return. JA A-434, A-437. (In a separate statement the British, while disavowing any "approval" by the UK of WWCR, acknowledged both UK acceptance of the senate reservation against article 9(4) and

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[22] This Court's 1983 recognition of the shortcomings of AL/SA has been borne out in the subsequent experience of federal tax authorities. In July 1990 I.R.S. Commissioner Fred T. Goldberg testified to Congress that, due to foreign corporations' AL/SA manipulations resulting in underreporting of income, the United States government is "being short-changed billions of dollars annually." *Tax Underpayments by U.S. Subsidiaries of Foreign Companies: Hearings Before the Subcomm. on Oversight of the House Comm. on Ways and Means,* 100th Cong., 2d Sess. (July 10 and 12, 1990) 72, 73. After hearing the testimony, Subcommittee Chairman J.J. Pickle concluded that underreporting by the U.S. subsidiaries of foreign multinationals was costing the U.S. Treasury a "sizable" figure, specifically referring to the opinion of one witness who testified that the tax shortfall exceeded $30 billion yearly. *Id.* at 380, 361. The problem continues, with gross taxpayer abuses of AL/SA transfer pricing provisions (which supposedly adjust intercompany sales to "arm's length" prices): "Transfer pricing is the most significant international compliance issue faced by the United States in recent years." Treasury Dept.-I.R.S. Joint Statement of Policy and Action Plan on International Tax Compliance (12/17/93); BNA Daily Rpt. for Executives (12/20/93).

the difficult issues raised "in seeking to limit State taxing powers" through treaties. JA A-99. That statement also recognized the final balance of the bargaining, proclaiming "the achievement of the two Governments in reaching a fair and balanced agreement." JA A-96 through A-97.) Under these circumstances, any United Kingdom retaliation for California's use of WWCR would be in violation of the bargained-for US/UK Treaty and thus clearly not justifiable. The Executive Branch has explicitly recognized that implementation of the latent UK retaliatory measure would clearly violate the US/UK treaty. Executive Branch testimony to Congress includes the following statement regarding the United Kingdom's retaliatory measure:

> "We believe that its existence is inconsistent with the U.S.-U.K. bilateral income tax treaty to the extent its threatened use causes U.S. taxpayers to refrain from claiming benefits under the treaty. *Its actual implementation would be a clear violation of the treaty.*" JA A-443 (emphasis added).[23]

c. Even if retaliation had once been justifiable, California's "water's edge election" would render retaliation currently unjustifiable.

As established above at pages 28-32, this Court's proper role in "one voice" issues is to "hold the fort" in protecting the national interest as to foreign commerce issues until Congress and the Executive Branch have had the chance to act. Even if it were determined that Congress had not acted to permit California's use of WWCR, Congress clearly has had the opportunity to act. The Executive Branch has been quite

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[23] Barclays quotes the superseded opinion of the Court of Appeal as asserting that although the UK retaliatory provision has never been implemented, " 'many' " American companies have been " 'propelled' " into " 'preimplementation compliance.' " Br. Pet. 26. The evidence in this case indicates that "some" ("one or two") American companies changed how they managed their funds in light of the existence of the dormant statute (R 180, 442), but this would not constitute compliance.

active and successful in achieving the cooperative harmonization of state tax prerogatives with national foreign policy interests, culminating in the Executive Branch's satisfaction with current California water's edge legislation.

Barclays is dialing "911" to ask this Court to take action as the ultimate "one voice" police force, a role this Court reluctantly assumes only when the courts must act to prevent imminent damage to national foreign commerce interests. But "911" calls are for emergencies, and there is no emergency here – Barclays is calling for this Court to invalidate a previous tax method, citing unjustified foreign retaliation threats which have now ebbed. This call for action should receive the same response which the police would give a "911" caller who wants emergency police action now to deal with a former problem which has been solved peacefully by neighborhood cooperation. It would be absurd for a state tax to be invalidated on a "one voice" basis of threats of foreign retaliation when under current circumstances those threats have absolutely no substance.[24]

[24] In its attempts to establish unconstitutionality, Barclays points to many events subsequent to 1978, such as UK enactment of retaliatory legislation in 1985. Br.Pet. 26. Twisting 180 degrees, Barclays then argues that "Subsequent Events [namely, California's enactments of water's edge legislation] Do Not Eliminate Unconstitutionality." Br.Pet. 41. The cases Barclays cites for its second approach to subsequent events deal with the rules for retroactive relief in discrimination cases. Those cases have nothing to do with the "one voice" element. There is a substantive difference in what interests are being protected when considering whether a state statute (1) discriminates against a taxpayer or, (2) as *Container* puts it (463 U.S. at 193), " 'prevents the Federal Government from "speaking with one voice" in international trade. . . . ' " The "one voice" protected interest is primarily that of the United States, with the taxpayer getting the benefit of the rule if, at the time of ultimate decision, conditions still exist which merit court action in the protection of that interest. If Congress has indicated that it can but does not wish to speak, and if the Executive Branch has adequately resolved the foreign affairs problem and indicates that it does not need or wish the Court's intervention, then intrusive court action would frustrate, rather than protect, the national interest which the "one voice" element is designed to protect.

d. Consideration of the three factors from *Container* does not establish any justifiable retaliation.

Given the above, there is no way that any foreign retaliation in this case is "justifiable." Under these circumstances the primary reason to consider the three retaliation factors which the *Container* decision applied to a unitary business headed by a domestic corporation (463 U.S. at 194-95) is to note how Barclays has tried to warp two of them into new tests favorable to Barclays. Under the first factor, Barclays must apply an admittedly non-*Container* definition of "automatic asymmetry" to try to pass the *Container* "automatic asymmetry" test. Under the test as actually applied in *Container*, this case presents no inevitable double taxation (see below at pp. 37-39), and therefore there is no automatic asymmetry. Similarly, Barclays would rewrite the third *Container* factor to be some sort of "allocation factor" test, while the whole point of the test as applied in *Container* is that "the fact remains that [taxpayer] is without a doubt amenable to be taxed in California in one way or another, and that the *amount of tax it pays* is much more the function of California's tax rate than of its allocation method." 463 U.S. at 195 (emphasis added). That is true here as well as in *Container*. Of course, the second factor in *Container* merely reserved the question which is presented for decision in this case. For the reasons already given above, it has been established that there are no valid grounds to apply the "one voice" element of dormant Foreign Commerce Clause analysis to invalidate California's 1978 application of WWCR to the taxpayers now before this Court.

B. There is no enhanced risk of double taxation violative of dormant Commerce Clause standards.

Barclays is wrong in claiming that "the taxpayers here unquestionably have established that double taxation has occurred." Br.Pet. 32. Certainly, under *Container* California's calculation of the worldwide net income of the unitary business before separating out California's share of that income

by WWCR does not by itself result in California's taxation of more than California's share. Compare Br.Pet. 33. Also, merely introducing the taxpayers' foreign returns (see Br.Pet. 32) does not establish multiple taxation.[25] In any event, even if, as in *Container*, it were to be assumed that double taxation exists, there would be no violation of the multiple taxation element of the dormant Foreign Commerce Clause analysis.

Barclays' double taxation analysis ignores the thrust and holding of *Container*'s multiple taxation section. Barclays would like to apply the multiple taxation test as framed for property taxes in *Japan Line*. However, in *Container* this Court made clear that it would be inappropriate to apply the *Japan Line* test to income taxation. 463 U.S. at 192-93. In doing so, this Court recognized that any method of income allocation for income taxes is an inexact process akin "to slicing a shadow." *Id.* at 192. Recognizing that the separate accounting rules of the various countries "often differ substantially" (*id.* at 191, 192-93; see in this case R 1772 (JA A-836), R 1789-91), this Court held that requiring California to use separate accounting "could not eliminate the risk of double taxation of corporations subject to its franchise tax, and might in some cases end up subjecting those corporations to more serious double taxation than would occur under formula apportionment." *Id.* at 191 (footnote omitted). Under these circumstances, and since California's tax method did not necessarily result in " 'inevitable' " double taxation in every case, this Court held that California's use of WWCR

[25] The United Kingdom's taxing authority recognizes that the method by which California or any other jurisdiction determines the amount of taxable income assigned to it is not controlling for purposes of calculating the United Kingdom's tax credits for avoidance of double taxation. Ex. 51W. The final California assessments attributed net income of £ 76,232.59 to BBI's California activities. Ex. 51V. That amount was less than 1/75 of all BBI profits attributed to the United States for purposes of the U.K. double tax credit. Ex. 51J. The BBI income attributed to California under WWCR clearly falls within the total income which the UK would attribute to the United States, and the California tax is therefore creditable. Since Barcal was a California corporation (JA A-11) and did not pay any dividends to its United Kingdom parent, BBI (Ex. 51W), there was no Barcal intercorporate dividend problem as contemplated in *Container*, 463 U.S. at 192 n. 30.

passed the dormant Foreign Commerce Clause test as to the enhanced risk of multiple taxation. *Id.* at 192-93.

Barclays has been unable to convince any court that the multiple taxation result would be any different in the present case. Barclays looks not to the *Container* holding (*id.* at 189-93), which supplies the multiple taxation test for income tax cases such as *Barclays*, but to the preliminary discussion in *Container* (*id.* at 187-89), which reviews certain differences and similarities between *Container* (an income tax case) and *Japan Line* (a property tax case). Br.Pet. 32-33.[26] While Barclays strains mightily to draw "one voice" considerations into the multiple taxation context, Barclays' analysis totally fails to recognize this Court's clear (and clearly applicable) multiple taxation holding: because California's WWCR does not result in inevitable multiple taxation in every case, and because requiring separate accounting would continue (and in some cases increase) the risk of multiple taxation, California's use of WWCR *in the income tax context* cannot be violative of the multiple taxation element of dormant Foreign Commerce Clause analysis.

[26] In *Itel Container Intern. Corp.* v. *Huddleston*, 113 S.Ct. 1095, 1103-04 (1993), this Court, in also distinguishing *Japan Line*, noted two major characteristics in *Container* which distinguished that case from *Japan Line*: (1) the double taxation problem was not the inevitable result of the California taxing scheme, and (2) the Executive Branch had decided not to file a brief in opposition to the tax. Both characteristics also apply to the present United States Supreme Court proceedings.

C. California's WWCR requirements are fully consistent with the nondiscrimination element of dormant Commerce Clause analysis.

1. Barclays' discrimination arguments are based on a compliance cost premise which disregards both authoritative California law and uncontradicted evidence.

Barclays bases its "discrimination" arguments on a totally false premise: that taxpayers cannot use any reasonable approximations when complying with California WWCR requirements. That was the mistaken premise adopted by the trial court, which found that the Barclays Group would have to spend millions of dollars setting up parallel sets of accounting books around the world in order to comply with the California law; it was those costs which the trial court found to be " 'prohibitive.' " See Br.Pet. 44 & n. 13. It was that mistaken premise which also led the Court of Appeal in its first opinion to term the California compliance burdens to be an "administrative nightmare." Br.Pet 44.[27] In its last opinion, the California Court of Appeal recognized that reasonable approximations were not only available to, but were used by, the Barclays taxpayers. PA D-13 to 14.

This Court has held that it is not free to overturn the California Court of Appeal's constructions of California state law when the California Supreme Court has denied review of

[27] No duplicate sets of books and records were needed to comply with WWCR. In addition to the general provision allowing the use of reasonable approximations, Barclays' " 'nightmare' " ignores the reality of other accommodating rules which are set forth in the compliance provisions of regulation 25137-6 (PA App. J). Those rules provide for net income determination by use of the regularly maintained financial records (records maintained in the parent's foreign currency, not dollars), then net income adjustments, only if material, to conform to United States GAAP and California tax accounting, and finally, after apportionment, the conversion of the net income result into dollars. The use of reasonable approximations in this process is explicitly permitted by the same regulation. Barclays' bizarre claim that use of reasonable approximations constitutes "wholesale non-compliance with the Regulation" (Br.Pet. 47 n. 15) is a wholesale misrepresentation of the regulation.

the case. *Hicks* v. *Feiock*, 485 U.S. 624, 629-30 (1988). The Court of Appeal's holding that California law permits the use of reasonable approximations when complying with WWCR, combined with the California Supreme Court's denial of review (PA App. E), provides the determinative interpretation of that state law. Barclays' attempts to premise its discrimination arguments on a contrary and erroneous interpretation of California law serve only to show Barclays' desperation in trying to cook up some basis for its position.

Although the Barclays taxpayers presented no evidence of their actual costs of compliance using reasonable approximations, defendant Board provided uncontested evidence concerning taxpayers' actual burden. Reference to the real world discloses that the Barclays taxpayers' compliance burden was not substantial.

During the 1970's, including the year at issue in this case, taxpayer BBI actually filed its California tax return on a WWCR basis (R 1441), including most but not all of the worldwide unitary business which BBI and the Board later stipulated to exist. As shown by the exhibits (Exs. RR, SS, TT, UU, (see JA 755 through 767) and 51P) introduced and discussed at pages 2113 through 2125 of the reporter's transcript, the California BBI returns were prepared by Price Waterhouse for income years 1972, 1973, and 1974; the most hours spent on any of those returns was 21 hours; the highest bill for the preparation of any of those returns was not in the millions of dollars, but was for $1,250. The reason is clear: these returns were prepared by using available documents and by applying the principles of materiality and reasonable approximations. The same is true of the income year 1977 (tax year 1978) WWCR return prepared by BBI itself. Although the Board found the unitary business to include more corporations than shown on the income year 1977 return, uncontradicted evidence (R 2115, 2124-25) indicates that preparation of the BBI return on this enlarged basis, using materiality and reasonable approximations, would take little more than 40 hours. Barclays' arguments and evidence regarding costs of compliance are purely hypothetical and have nothing to do with the facts of this case.

2. The use of reasonable approximations to comply with WWCR does not deprive any taxpayer, foreign or domestic, of tax benefits.

Barclays then argues that use of reasonable approximations would necessarily deprive a taxpayer of tax benefits. To the contrary, the record in this case contains uncontested instances of the availability of tax benefits (such as depreciation and bad debt deductions) within the California system's use of reasonable approximations and materiality. R 1467-69, 1471-72. The portions of the record cited on page 47 of the Barclays brief either (1) speak to what would be required to establish such tax benefits if reasonable approximations were not used, or (2) are fragments of testimony of witnesses who erroneously rejected the availability of reasonable approximations or who took the unrealistic position that one would have to know all the exact (and prohibitively costly) information before deciding whether to use any approximations.[28] *The Barclays taxpayers presented no evidence showing that they were actually deprived of any tax benefit in this case* because of the reasonable approximations which were in fact used to determine their final liabilities.

In any event, if the use of reasonable approximations somehow meant that tax benefits would become unavailable, the federal tax law's arm's-length method would fail in the same manner, for, as the taxpayers' own expert witness testified, application of the federal system also depends on the use of reasonable approximations. JA A-829; see also 26 C.F.R.

[28] Since this issue involves questions of materiality of differences between benefit amounts derived from financial records and benefit amounts derived from fully developed tax accounting records, it should be noted that uncontradicted evidence established that a $1 million reduction to worldwide income (as would result from a $1 million increase in depreciation) would result in only a $40 reduction in ultimate California tax dollars due from BBI ($1727 tax reduction for Barcal). Ex. BB; R 1556. Therefore, it cannot be presumed that use in this case of book depreciation as a reasonable approximation of tax accounting depreciation (R 1467-68) made any material difference in the Barclays taxpayers' taxes. Certainly such use, which perhaps led to a better result for Barclays than use of the exact tax accounting figures would have, did not deprive them of the depreciation benefit.

§ 1.805- 5(a)(4)(iv)(b). In complying with California tax law, which differs from federal law in many respects, both domestic-based and foreign-based businesses had to rely on reasonable approximations, for the costs of compliance without such reliance would have been prohibitive for domestic-based as well as foreign-based businesses. JA A-842 to A-843.

3. California requires the same information and taxes from every taxpayer, whether its unitary business is domestic-based or foreign-based; California's tax could not become unconstitutionally discriminatory because of different burdens imposed within federal tax law.

Although its dormant Commerce Clause analysis was not necessary, the California Court of Appeal reached the correct conclusion as to the discrimination element. It correctly noted that under California law both foreign-based and domestic-based unitary groups "are treated the same – they face the same tax rate and must furnish the same kind of information." PA D-10. The fact that domestic groups, but not foreign-based groups, might also have to supply the same type of information to comply with United States tax laws does not inject discrimination into the evenhanded California tax requirements. PA D-10 to D-11.

The Court of Appeal correctly relied upon this Court's recent decision in *Kraft General Foods* v. *Iowa Dept. of Revenue*, ___ U.S. ___, 112 S.Ct. 2365 (1992). In *Kraft* this Court held that an Iowa tax law discriminated against foreign commerce because "Iowa imposes a burden on foreign subsidiaries that it does not impose on domestic subsidiaries." *Id.* at 2371 (footnote omitted). This Court also noted that if a state's tax system "does not favor business activity in the United States generally over business activity abroad[,] . . . this would indeed suggest that the statute does not discriminate against foreign commerce." *Id.* at 2370. As recognized by the California Court of Appeal, California applies exactly the *same* tax and information requirements to all businesses,

whether they have foreign connections or solely domestic connections. The fact that the Barclays group does not have to meet certain United States *federal* tax accounting requirements which domestic groups must fulfill separately from the California requirements does not render California's law discriminatory as to members of the Barclays group. See *Cotton Petroleum Corp.* v. *New Mexico,* 490 U.S. 163, 189 (1989), where this Court held that New Mexico's taxes were not unconstitutionally discriminatory:

> "The burdensome consequence is entirely attributable to the fact that the [taxable activities] are located in an area where two governmental entities share jurisdiction. . . . . [T]he New Mexico taxes are administered in an evenhanded manner and are imposed at a uniform rate throughout the State. . . . "[29]

In sum, the Barclays taxpayers have decided to do business in a jurisdiction which evenhandedly imposes the same tax and compliance burdens on *all* corporate taxpayers. As noted by the Court of Appeal:

> "[A] foreign-based multijurisdictional enterprise, in complying with a particular jurisdiction's taxation scheme, must always present its tax information in the language, currency and accounting principles the authorities in that jurisdiction understand. This does not constitute a *direct* commercial advantage to unitary groups based in that jurisdiction. At most, it constitutes an indirect cost inherent in doing business in *foreign* lands." PA D-10 (emphasis in original).

In any event, once it is determined that a state tax is not discriminatory on its face, the discrimination element of the dormant Commerce Clause analysis is satisfied if the tax is fairly apportioned. *Trinova Corp.* v. *Michigan Dept. of Treasury*, 498 U.S. 358, 385 (1991). In this case, consistent with

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[29] Compare *Fort Gratiot Sanitary Landfill, Inc.* v. *Michigan Dep't of Natural Resources*, ___ U.S. ___, 112 S.Ct. 2019 (1992) (Br.Pet. 45), where the statute drew a geographical line between categories of those who would be permitted to do a certain kind of business and those who would not be so permitted, and all out-of-state businesses were in the prohibited category.

this Court's holding in *Container* that the California tax system provides for fair apportionment of taxable income (463 U.S. at 180-84; see also above at pages 9, 33), the Barclays taxpayers have stipulated that they are not challenging the fairness of California's apportionment of income under WWCR. R 1551 (JA 832 to 833). Therefore, no discrimination is present for purposes of dormant Commerce Clause analysis.[30]

IV. THE DETERMINATION OF THE FOREIGN COMMERCE CLAUSE ISSUE IN THIS CASE PRECLUDES ANY FOREIGN AFFAIRS PREEMPTION ISSUE.

A foreign affairs preemption issue simply cannot be determinative in this foreign commerce context. An issue pertaining directly to the Foreign Commerce Clause is at the heart of the California Supreme Court's opinion. It is undisputed that the Constitution gives Congress alone the power "[t]o regulate commerce with foreign nations. . . . " U.S. Const. art. I, § 8(3). If, as the California Supreme Court has held, proper application of the *Wardair* rule in this case confirms that federal foreign commerce law contains permission for the states' use of WWCR, then no contrary foreign affairs aspirations of the Executive Branch could eclipse that permission. The Executive Branch's power in the field of foreign relations, " 'like every other governmental power, must be exercised in subordination to the applicable provisions of the Constitution.' " *Dames & Moore* v. *Regan*, 453 U.S. 654, 661 (1981), quoting *United States* v. *Curtiss-Wright Export Corp.*, 299 U.S. 304, 319-20 (1936).

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[30] Although it did not apply *Trinova*, the California Court of Appeal correctly distinguished the *Barclays* context from such cases as *Hunt* v. *Washington State Apple Advertising Comm'n*, 432 U.S. 333 (1977), on the basis that *Hunt*, with a facially neutral statute, involved more burdens than just compliance costs – in *Hunt* only out-of-state growers had to alter existing beneficial marketing practices – whereas *Barclays* involves only compliance costs in a context wherein foreign-based multinationals and domestic-based multinationals "must both furnish the same kind of information." PA D-11, n. 4.

But what of authorities such as *Hines* v. *Davidowitz*, 312 U.S. 52 (1941), and *Zschernig* v. *Miller*, 389 U.S. 429 (1968)? Barclays relies on these cases as barring any state act which has a direct impact upon foreign relations and which may adversely affect the power of the central government to deal with foreign affairs issues. The answer in this case must be given in the context of foreign commerce. If Congress has acted to permit state action in a foreign commerce context, no further authorization is needed, even though foreign relations are necessarily also involved. See *Wardair*, 477 U.S. at 12-13; see also *United States* v. *Guy W. Capps, Inc.*, 204 F.2d 655 (4th Cir. 1953), *aff'd on other grds.*, 348 U.S. 296 (1955).

Alternatively, in a dormant Foreign Commerce Clause context where no congressional acquiescence or prohibition is present, the *Container* decision teaches that a state tax at variance with the federal tax approach and affecting foreign commerce will violate the Foreign Commerce Clause if it " 'may impair federal uniformity in an area where federal uniformity is essential' . . . and 'prevents the Federal Government from "speaking with one voice" in international trade. . . . ' " 463 U.S. at 193. In reaching its Foreign Commerce Clause holding, *Container* contains many references to "foreign affairs," "foreign relations," and "foreign policy" (see 463 U.S. at 189, 194, 195, 196, 197); it rejected the dissent's position that California's application of WWCR was "an intrusion on national policy in foreign affairs that is not permitted by the Constitution." 463 U.S. at 206 (dissent). Thus, under *Container*, a dormant Foreign Commerce Clause holding in favor of WWCR includes consideration and determination of foreign affairs issues, leaving no room for any determination that the federal government's foreign affairs powers bar the application of WWCR to that taxpayer. This is consistent with the rule that the Congress and the President share authority over foreign affairs. See *Container*, 463 U.S. at 196; *Zschernig* v. *Miller*, 389 U.S. 429, 432 (1968). If a state tax affecting foreign commerce is valid either by way of congressional authorization or under the dormant Foreign

Commerce Clause tests (which include the balancing of foreign policy considerations), it cannot be unconstitutional on the basis of infringement upon foreign affairs.

This Court cannot construe Executive Branch foreign policy aspirations as authoritative federal policy without disabling not only Congress but also the Constitution, which requires that treaties can become law only upon ratification by two-thirds vote of the Senate. U.S. Const. art. II, § 2 (Opp. Pet. App. A). By rejecting the Executive Branch's 1970's aspirations which were given voice in proposed article 9(4) of the US/UK Treaty, Congress' implied acquiescence in state use of WWCR has become a part of the "supreme law of the land" (U.S. Const. art. VI(2)). That law cannot now be voided merely by relabeling the Executive Branch's thwarted aspirations as "foreign policy."

V. CALIFORNIA'S APPLICATION OF WORLDWIDE COMBINED REPORTING TO THE BARCLAYS TAXPAYERS DID NOT VIOLATE DUE PROCESS.

After holding that Congress had exercised its Commerce Clause powers to permit California's use of WWCR, and having thus determined that no dormant Commerce Clause analysis could alter that permission, the California Supreme Court remanded the case to the California Court of Appeal for determination of the due process issues. PA C-38 to C-39. The Court of Appeal then confirmed that California law provides for (1) the avoidance of oppressive costs of compliance through the use of reasonable approximations and the principle of materiality (PA D-13 to D-14, D-20 to D-21, D-23 to D-24) (see discussion above at pp. 40-41) and (2) full judicial review of any claimed abuses of discretion by the taxing agency in the application of this procedure (PA D-21, D-23). On the basis of its construction of California law, the Court of Appeal held that there was no violation of due process in this case. PA D-27. The California Supreme Court denied Barclays' petition for review of this construction and holding. PA

E-1. Only the due process holding, not the state law construction, is properly before this Court for review. See above at pp. 40-41.

Barclays claims that the test of "reasonable approximations" provides "no standard to determine what 'approximations' will be accepted." Br.Pet. 49 (footnote omitted). Given the California court's carefully circumscribed construction of regulation 25137-6 (PA App. J),[31] given this Court's established use of the standard of "reasonable" as providing sufficient and appropriate guidance in the due process area,[32] and given the total lack of any showing by taxpayers that there was any abuse of discretion in the final administrative result in this case, Barclays' due process argument necessarily fails on the merits.

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[31] "[T]he Board must consider the cost and effort of producing WWCR information in deciding whether to accept reasonable approximations, and that consideration is to use regularly-maintained or other readily-accessible corporate documents as the cost guideline." PA D-21. "[T]he Board's discretion regarding reasonable approximations is circumscribed and guided by our interpretation of section 25137-6(e)(1)'s mandatory consideration of cost and effort." PA D-23.

[32] Barclays cites *Grayned* v. *City of Rockford*, 408 U.S. 104, 108 (1972), as its primary authority for what constitutes unconstitutional vagueness, without recognizing that *Grayned* itself uses "reasonable" as a standard: *Grayned* requires that a law give "reasonable opportunity to know what is prohibited." *Id.* Also, due process nexus requirements for taxation recently have been set in terms of what is "reasonable." *Quill Corporation* v. *North Dakota*, ___ U.S. ___, 112 S.Ct. 1904, 1910 (1992). The Fourth Amendment of the Constitution itself protects against "unreasonable" searches and seizures, and due process requires that a criminal guilt be proven beyond a "reasonable" doubt (*Austin* v. *United States*, ___ U.S. ___, 113 S.Ct. 2801, 2804-05 n.4 (1993)). Determinations by reference to "a standard of 'reasonableness' [are] not unusual under federal income tax laws" (*United States* v. *Ragen*, 314 U.S. 513, 522-24 (1942)), and Barclays' expert witness established that federal application of separate accounting involves administrative determinations of what constitutes a "reasonable approximation" (R 1270; JA 829). As to judicial review, this Court has long recognized that whether an action taken is "reasonable" is an "everyday subject[] of inquiry by courts in framing and enforcing their decrees." *Virginian Ry.* v. *Federation*, 300 U.S. 515, 550 (1937).

CONCLUSION

For the reasons given above, it is respectfully submitted that the California decision should be affirmed.

Dated: January 19, 1994.

Respectfully submitted,

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APPENDIX A

ARTICLE 9, PARAGRAPHS (4) AND (5) OF UNITED STATES/UNITED KINGDOM INCOME TAX TREATY AS ORIGINALLY NEGOTIATED BY EXECUTIVE BRANCH IN 1975 AND PRESENTED TO THE SENATE IN 1976

Article 9

Associated Enterprises

. . . .

(4) Except as specifically provided in this Article, in determining the tax liability of an enterprise doing business in a Contracting State, or in a political subdivision or local authority of a Contracting State, such Contracting State, political subdivision, or local authority shall not take into account the income, deductions, receipts, or outgoings of a related enterprise of the other Contracting State or of an enterprise of any third State related to an enterprise of the other Contracting State.

(5) For the purposes of this Convention, an enterprise is related to another enterprise if either enterprise directly or indirectly controls the other, or if any third person or persons (related to each other or acting together) control both.

[31 United States Treaties 5668, 5677]